

NORTH DAKOTA STATE FIRE & TORNADO FUND

INVESTMENT POLICY STATEMENT

1. FUND CHARACTERISTICS AND CONSTRAINTS.

The State Fire and Tomado Fund (the Fund) was established in 1919 to insure the various state industries and political subdivisions against direct physical loss to public buildings, fixtures, and permanent contents due to the perils named in 26.1-22-02 of the North Dakota Century Code (NDCC). All state buildings and universities must be covered by the Fund. School districts and counties may participate at their option.

Funding is primarily provided by annual premiums charged to policy holders in accordance with NDCC 26.1-22. Premiums are expected to total approximately \$3.7 million annually, with the bulk of these premiums received at the beginning of each fiscal year.

Effective August 1993, the state's boiler inspection program was placed under the direction of the Insurance Department. The costs of this program are appropriated from the Fund. Fees collected for boiler inspections and licensing will be the primary source of funding for the program. The 1995 Legislature added anhydrous ammonia storage facilities to the Fund's inspection responsibilities.

A minimum balance of \$12.0 million must be maintained at all times. If reserves drop below this statutory minimum, additional premiums, as specified under NDCC 26.1-22, would be assessed. This situation must be avoided.

The Fund retains liability for the first \$2 million on each and every loss. Any loss over this amount, up to a maximum of \$100 million, is covered by reinsurance through a commercial reinsurance carrier. Reinsurance coverage is re-bid by the Insurance Department every two years.

Claims paid from the Fund are highly unpredictable. Weather damage accounts for the majority of claims. Fires generally result in the most extensive damage.

Generally, there is a 30-day lead time to prepare for a claim payment. Large claim payments have a longer lead time and are spread out in multiple payments whenever possible. Total claim payments and transfers over the last four fiscal years have averaged \$4.3 million annually.

Operating expenses are paid from the Fund as incurred. These include Fund administration, boiler inspection program, anhydrous ammonia storage facility inspections, State Fire Marshall's Office, and State Firemen's Association. For planning purposes over the 2003-2005 biennium, these appropriations were assumed to be \$707,288 annually.

The Fund's asset allocation will need to be reviewed at the end of the 2003-2005 biennium for appropriateness.

2. RESPONSIBILITIES AND DISCRETION OF THE STATE INVESTMENT BOARD (SIB).

The SIB is charged by law under NDCC 21-10 with the responsibility of establishing investment policy and investing the assets of the Fund. The assets are to be invested in a manner consistent with the prudent investor rule as provided in NDCC 21-10-07.

At the discretion of the SIB, the Fund's assets may be pooled with other funds. In pooling funds, the SIB may establish whatever asset class pools it deems necessary with specific quality, diversification, restrictions, and performance objectives appropriate to the prudent investor rule and objectives of the funds participating in the pools.

The SIB may delegate investment responsibility to professional money managers. When a money manager has been retained, the SIB's role in determining investment strategy and security selection is supervisory, not advisory.

The SIB is responsible for establishing criteria and procedures and making decisions with respect to hiring, maintaining, and terminating money managers. This responsibility includes selecting performance measurement services, consultants, and report formats and determining the frequency of meetings with managers.

3. INVESTMENT OBJECTIVES.

The investment objectives of the Fund reflect the long-term nature of the Fund, but also the low risk tolerance and shorter-term liquidity needs. Operating and statutory considerations shape the Funds policies and priorities as outlined below:

Objective #1: Investment income is needed to provide stability for insurance reserves. This will be achieved through a diversified portfolio of high quality fixed income and equity assets.

Objective #2: Growth of capital is needed to provide an inflationary hedge and add to the growth of surplus. Capital growth will be sought through investment in equities and/or equity substitutes.

Objective #3: Sufficient liquidity is to be maintained to meet known or anticipated financial obligations and preserve the value of the surplus. Cash equivalent investments will be used to achieve this objective.

Objective #4: The risk of violating the statutory minimum balance requirement of \$12,000,000 is to be minimized. This will be achieved by an asset allocation consistent with this objective.

4. STANDARDS OF INVESTMENT PERFORMANCE.

The Fund's investment objectives and liquidity constraints give rise to an asset allocation that is considered the most likely to achieve the results desired. For evaluation purposes, the following performance targets will apply:

- a. The Fund should produce a rate of return that meets or exceeds the portfolio policy index defined as 15% S&P 500 domestic stock index, 5% Russell 2000 domestic small cap index, 10% MSCI EAFE international stock index, 10% First Boston Convertible Securities index, 50% Lehman Government/Corporate domestic bond index, and 10% 90-day Treasury bills.
- b. The annual standard deviation of total returns for the Fund should not exceed that of the policy portfolio.

5. POLICY AND GUIDELINES.

The asset allocation of the State Fire & Tornado Fund is established by the SIB, with input from the Insurance Department. Asset allocation is based upon the appraisal of projected liquidity and income requirements, and estimates of the investment returns likely to be achieved by the various asset classes over the next five years.

In recognition of these factors, the following allocation is deemed appropriate for the fund:

| | |
|---------------------------|------|
| Large Cap Domestic Equity | 15 % |
| Small Cap Domestic Equity | 5 % |
| Convertible Bonds | 10 % |
| International Equity | 10 % |
| Fixed Income | 50 % |
| Cash Equivalents | 10 % |

Rebalancing of the Fund to this target will be done in accordance with the SIB's rebalancing policy.

While the SIB is responsible for establishing specific quality, diversification, restrictions, and performance objectives for the investment vehicles in which the Fund's assets will be invested, it is understood that:

- a. No derivative instruments or strategies which make use of derivatives which would cause the portfolio to be in any way leveraged will be used.
- b. Derivative use will be monitored to ensure that undue risks are not taken by the money managers.
- c. All assets will be held in custody by the State Investment Board's master custodian or such other custodians as are acceptable to the State Investment Board.
- d. No funds shall be borrowed.
- e. No short sales or margin purchases shall be made.


6. EVALUATION AND REVIEW.

Investment management of the Fund will be evaluated against the Fund's investment objectives and investment performance standards. Evaluation will be conducted quarterly by the SIB through its review of funds participating in the Insurance Trust.

Money managers will be evaluated by the SIB quarterly. In-state meetings will be held with the money managers at least annually.

Approved by:

INSURANCE DEPARTMENT



Jim Poolman
Commissioner of Insurance

Date:

6/24/03

STATE INVESTMENT BOARD



Steve Cochran
Executive Director/Investment Director, RIO

Date: 6-27-03



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Memo

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Commissioner of Insurance
State of North Dakota

To: Ken Rood, Insurance Dept Funds
From: Connie Flanagan *CF*
Date: March 2, 2004
Re: Adjustment to Investment Guidelines

We are in the process of reviewing all of the Investment Guideline Statements for the funds invested by the State Investment Board (SIB). We would like to request a change in the language in Section 5 of your statement regarding allowable investments.

In subsection "a." we would like to change the policy "No derivative instruments or strategies which make use of derivatives which would cause the portfolio to be in any way leveraged will be used." We recommend changing it to, "Futures and options may be used to hedge or replicate underlying index exposure, but not for speculation."

In subsection "e." we would like to change the policy "No short sales or margin purchases shall be made." We recommend changing it to, "No unhedged short sales or speculative margin purchases shall be made."

These changes will facilitate the hiring of an additional large cap domestic equity manager who utilizes a futures strategy in an enhanced index portfolio. In the essence of time, we request that you indicate your approval of this change by signing below and returning this memo to us. You may want to keep a copy for your records. We will send out complete revised guidelines statements in the near future.

I approve of the changes indicated above. Signed

Date

Ken Rood
3/4/04